Response of
Wisconsin Power and Light Company
to
The Public Service Commission of Wisconsin
Data Request No. 3.01

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Information Requested By:	Ken Detmer
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P. 12, par 3: Provide discussion on why WPL is not pursuing environmental trust financing.

Response:

WPL reviews the alternative financing mechanisms available to it on an ongoing basis, including securitization in general and environmental trust financing in particular. In the case of the Edgewater Generating Station Unit 5 NO_x Reduction Project, WPL does not consider securitization or environmental trust financing an appropriate alternative.

Securitization is best suited to finance unexpected materially adverse developments that cause major losses of utility rate base and utility revenue. Recent examples include weather-related catastrophes (such as Hurricane Katrina in Louisiana as it impacted Entergy's New Orleans operations and the occurrence of multiple major storms in a single hurricane season as they impacted Florida Power and Light Company) and major asset value impairment from the stranded costs resulting from mandated deregulation (such as those arising from the sale of generation plants in Illinois). In these cases, a utility can face severe financial stress from the simultaneous need to repair and replace capital equipment, to absorb unbudgeted operating costs, and to face load losses and the associated reduction in revenue streams. These sudden, unexpected and major financial adversities can threaten the utility company with credit rating downgrades, and even bankruptcy in extreme situations. Raising the funds required to recover from these adversities can further strain the utility's creditworthiness, and cause such transactions to be priced at relatively high marginal costs when compared to prior transactions undertaken by that same utility and to the costs for similar utility companies that are raising funds at about the same time. Those are the conditions under which an alternative to conventional utility financing, such as structured securitized financing, may become worthy of serious consideration.

Environmental trust financing is a subset of structured securitized financing, whereby a special-purpose bankruptcy-remote financing entity is created for the sole purpose of issuing negotiable securities, the proceeds of which are applied to fund environmental capital expenditures being contemplated by a utility company. On behalf of the special-purpose financing entity, the utility company commits to legally segregate and collect the amounts required to service that financing entity's obligations under those securities, in contrast to the conventional direct financing arrangements normally undertaken to fund additions to its rate base. In short, the securitization allows a utility under stress to raise the money required immediately by irrevocably diverting future revenue to service a special-purpose entity's obligations. Structured financing should be considered if the terms show promise of being less onerous than those that would apply to it raising the funds directly, due to unexpected materially adverse developments. It can be a lower cost to securitize future revenues because the associated credit risks are not entirely reliant on the utility company's own creditworthiness, which may have been badly compromised by the adverse turn of events. The order of magnitude of the funding requirement is also important in rendering securitization potentially more attractive, since the larger size of the financing undertaken helps offset the more complex structuring and documentation costs up front. Inter-generational equity is better served by helping to spread the major losses and the high up-font financing costs over time to future ratepayers, who also benefit from the non-recurring recovery costs undertaken in response to the extraordinary adverse developments.

That is not the situation WPL faces in funding the Edgewater Generating Station Unit 5 NO_x Reduction Project. WPL is not facing an unexpected materially adverse development that has caused major losses of utility rate base and utility revenue. WPL is not proposing to raise a large enough amount of debt to compensate the distinctly larger up-front structuring costs and documentation associated with a securitization, compared to a conventional debt offering. Conventional debt offerings also have the advantages of being less complex, more flexible in their covenants and other conditions, and more flexible in allowing WPL to approach the capital markets with appropriate timing, all important factors in the currently uncertain economic and financial environment WPL is operating in. The credit rating agencies have indicated that there is a limit to the amount of securitization any company can undertake before it begins to compromise that company's risk profile, which in turn undermines its assigned credit ratings, as well as threaten to constrain its access to the capital markets and to increase its cost of capital, to the ultimate detriment of ratepayers. Finally, the high-grade corporate debt markets, which WPL can still access directly in its own name, have not been as adversely affected by economic and financial market disruption as the structured securitized debt markets, notably the mortgage-related and consumer receivables securitization markets, which have been severely disrupted by economic and financial market developments over the past two years. For these multiple reasons, WPL does not propose using environmental trust financing to fund the debt portion of the amount required for the Edgewater Generating Station Unit 5 NO_x Reduction Project.